81-993

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No. ...
IN THE

Supreme Court of the United States

October Term, 1981

CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION,
Appellant,

vs.

NINI MYRNA TAN, *et al.*,
Appellees.

CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION,
Appellant,

vs.

WILLIAM ROMAGNOLI, *et al.*, (and Consolidated Cases),
Appellees.

On Appeal From the California Court of Appeal, Fourth Appellate District.

JURISDICTIONAL STATEMENT.

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Questions Presented.

A. Does the Home Owners' Loan Act, 12 U.S.C. §1461 *et seq.*, and related Federal Home Loan Bank Board regulations authorizing the use of due-on-sale clauses in the lending instruments of federal savings and loan associations, preempt state law that severely restricts the use of such clauses?

B. Does the application of a state court decision that severely restricts the use of due-on-sale clauses to lending instruments executed prior to that decision constitute an unconstitutional divestiture of vested contract rights in violation of the due process clause of the fourteenth amendment to the United States Constitution?

C. Does retroactive application of that state court decision result in an unconstitutional impairment of the obligation of contracts in violation of Article I, Section 10 of the United States Constitution?

List of All Parties.

This appeal is taken jointly from six cases, five of which were consolidated for all purposes in the lower appellate court. The cases and parties are:

Case 1:

Tan, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23471

Parties:

NINI MYRNA TAN (Plaintiff)
EUGENIE GOSLING (Plaintiff)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Defendant)

Case 2:

Romagnoli, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23023

Parties:

WILLIAM ROMAGNOLI (Plaintiff)
FELICE ROMAGNOLI (Plaintiff)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Defendant)

Case 3:

Ben, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23102

Parties:

JOHN WILLIAM BEN (Plaintiff)
SARAH L. BEN (Plaintiff)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Defendant)

Case 4:

Hanlon, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23103

Parties:

GEORGE A. HANLON (Plaintiff)
JANIS E. HANLON (Plaintiff)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Defendant)

Case 5:

Dunn, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23201

Parties:

MICHAEL J. DUNN (Defendant and Cross-complainant)
DIANNE R. DUNN (Defendant and Cross-complainant)
H. LAVERNE SMITH (Defendant and Cross-complainant)
ALMA P. SMITH (Defendant and Cross-complainant)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Plaintiff and Cross-defendant)

Case 6:

Renner, et al. v. California Federal Savings and Loan Association, et al.

Court of Appeal for the State of California, Fourth Appellate District, Division Two; 4 Civ. No. 23341

Parties:

WILLIAM A. RENNER (Plaintiff)
BEVERLY E. RENNER (Plaintiff)
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION (Defendant)

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Appellees.

JURISDICTIONAL STATEMENT.

OPINIONS OF COURT BELOW.

None of the opinions of the lower appellate court was published. Nevertheless, these cases were decided contemporaneously with and were controlled by the opinion of the California Court of Appeal, Fourth Appellate District, in *Reginald de la Cuesta, et al. v. Fidelity Federal Savings & Loan Ass'n*, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981).

STATEMENT OF GROUNDS FOR UNITED STATES SUPREME COURT JURISDICTION.

These are appeals from decisions of the California Court of Appeal, Fourth Appellate District, Second Division, upholding the validity of a California state law that was challenged by appellant California Federal Savings and Loan Association as being repugnant to the Constitution and laws of the United States. The appeals consist of the *Romagnoli, Ben, Hanlon, Dunn,* and *Renner* cases, which were consolidated in the court of appeal, and the *Tan* case.

The Opinion of the court of appeal in the *Tan* case was filed on July 2, 1981. Appellant California Federal Savings and Loan Association ("Cal Fed") filed a petition for rehearing on July 17, 1981; that petition was denied on July 22, 1981, but the court of appeal subsequently filed a modification of its Opinion that did not affect the judgment on July 31, 1981. Cal Fed then filed a petition for hearing in the California Supreme Court on August 4, 1981. That petition was denied on August 26, 1981. A notice of appeal was filed in the court of appeal on November 12, 1981.

The *Romagnoli, Ben, Hanlon, Dunn* and *Renner* cases were all treated as a single consolidated case for briefing in the court of appeal. The opinions in those cases were filed in the court of appeal on July 2, 1981. A petition for rehearing was filed on July 17, 1981 and denied on July 22, 1981. A petition for hearing was filed in the California Supreme Court on August 11, 1981 and denied on August 26, 1981. A notice of appeal was filed in the court of appeal on November 12, 1981.

The underlying disputes in *Tan* and the *Romagnoli* consolidated cases raise the common question of whether due-on-sale clauses in real estate secured lending instruments executed by appellees' predecessors-in-interest in favor of appellant are enforceable according to their terms and in accordance with Federal Home Loan Bank Board ("Bank Board") regulations, or are unenforceable by reason of

California Civil Code §711 as that statute has been construed in the decision of the California Supreme Court in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978). That decision held that a due-on-sale clause could not be enforced by an institutional lender unless the lender affirmatively proved that a transfer of the property serving as security for the loan transaction impaired the lender's security or increased the risk of default on the loan so secured. A due-on-sale clause typically permits a lender to accelerate the entire unpaid balance of a loan when the borrower sells the property serving as security for the loan.

The statutory provision conferring appellate jurisdiction upon this Court is 28 U.S.C. §1257(2). The case authority supporting this appeal appears in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 440-41 (1979). In *Japan Line* the appellants drew in question the validity of California's *ad valorem* property tax, contending that the tax, as applied to their shipping containers, was repugnant to the Commerce Clause and various treaties. The California Supreme Court sustained the validity of the tax. This Court said that "[u]nder these circumstances, this Court's appellate jurisdiction would seem manifest." 441 U.S. at 440. In rejecting appellees' contention that the California Supreme Court did not uphold the statute against constitutional attack, this Court concluded that:

> Appellants squarely challenged the constitutionality of the tax statute, as applied, and the California Supreme Court just as squarely sustained its validity, as applied. We have held consistently that a state statute is sustained within the meaning of §1257(2) when a state court holds it applicable to a particular set of facts as against the contention that such application is invalid on federal grounds. We conclude that we have appellate jurisdiction of this case. 441 U.S. at 440-41 (citations omitted).

Other cases sustaining the appellate jurisdiction of this Court in this case are: *Cohen v. California*, 403 U.S. 15, 17-18, *reh. denied*, 404 U.S. 876 (1971); *Warren Trading Post Co. v. Arizona Tax Comm'n*, 380 U.S. 685, 686 n.1 (1965); *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58, 61 n. 3 (1963); *Dahnke-Walker Milling Co. v. Bondurant*, 257 U.S. 282, 288-90 (1921).

CONSTITUTIONAL PROVISIONS, STATUTES, REGULATIONS, AND OTHER RELEVANT AUTHORITIES.

U.S. Constitution art. I, §10
U.S. Constitution art. VI, cl. 2
California Constitution art. 1, §9
Home Owners' Loan Act of 1933, 12 U.S.C. §1464(a)
28 U.S.C. §1257(2)
California Civil Code §711
12 C.F.R. §§545.8-3(f&g), 556.9
(These are reprinted in full in the Appendix.)

STATEMENT OF THE CASES.

A. The Tan Case.

On April 5, 1976, appellees' predecessors-in interest (the Wilsons) borrowed $102,800 (the "Wilson loan") from appellant Cal Fed. This loan was evidenced by a note and deed of trust secured by improved (multi-unit residential) real property located in Huntington Beach, California (the "property"). Both the note and deed of trust contained identical due-on-sale clauses that entitled Cal Fed to accelerate the loan and declare the entire balance immediately due and payable in the event the property securing the deed of trust was sold without the express written consent of Cal Fed.

Thereafter, the property was conveyed to the Newmans, who took the property subject to the Wilsons' deed of trust. On October 29, 1976, Cal Fed was advised of this transfer of title to the property. In response to a request from counsel for the Newmans, Cal Fed agreed to enter into a reservation

of rights agreement with the Newmans. The Newmans agreed to make payments on the Wilson loan and agreed further that acceptance of such payments by Cal Fed would not constitute a waiver of any of Cal Fed's rights under the deed of trust, specifically the right to enforce the due-on-sale clause.

On June 9, 1977, counsel for appellees advised Cal Fed that the property had been transferred once more, this time to appellees. Again, Cal Fed was requested to execute a reservation of rights agreement. After some inquiries, Cal Fed learned that there had been several intervening conveyances of the property, and refused to execute the proposed agreement. Instead, Cal Fed requested that the Newman agreement be assigned to appellees and that each of the intervening transferees also execute the assignment.

Upon appellees' refusal to comply with Cal Fed's requested assignment of the reservation of rights agreement, Cal Fed commenced nonjudicial foreclosure proceedings by recording a "Notice of Default and Election to Sell" the property on April 18, 1978, pursuant to its rights that accrued under the due-on-sale clause upon the initial unconsented-to conveyance of the property by the Wilsons.

Appellees then sought and, on August 14, 1978, obtained a preliminary injunction restraining Cal Fed from proceeding with a foreclosure under its power of sale in the deed of trust, asserting that Cal Fed was not entitled to accelerate the loan in light of *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), and that, therefore, there had been no default under the Wilson note and deed of trust. The gravamen of the complaint was that Cal Fed's exercise of the due-on-sale clause contained in the Wilsons' deed of trust and note was unlawful under California Civil Code §711* (as interpreted in the *Wellenkamp* case) as an unreasonable restraint on alienation.

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*"*Conditions restraining alienation void.* Conditions restraining alienation, when repugnant to the interest created, are void." Calif. Civil Code §711.

Thereafter, appellees decided to sell the property to persons not party to this lawsuit. On June 22, 1979, Cal Fed sent a Demand Statement to Paradise Escrow Inc., which was handling the closing of appellees' sale of the property. Appellees paid the sum demanded into escrow and Cal Fed executed the requisite reconveyance.

Appellees then filed a Supplemental and Amended Complaint, alleging five purported causes of action: (1) for declaratory relief, (2) for damages for overpayment, (3) for attorneys' fees, (4) to remove cloud on title, and (5) for injunctive relief.

Cal Fed successfully demurred (raising the federal question now presented by this appeal) to each cause of action in the Supplemental and Amended Complaint. On appeal, the court of appeal reversed.

B. The Romagnoli Consolidated Cases.

1. Romagnoli.

As security for a loan of $40,800.00 from Cal Fed, Les and Carole Amoy executed a deed of trust securing a promissory note which was recorded on December 28, 1973 and contained a due-on-sale clause. The loan was obtained to finance the purchase of a dwelling in Mission Viejo, California.

On July 16, 1979, the Amoys transferred the property to William and Felice Romagnoli without the consent of Cal Fed. Cal Fed accelerated the loan and demanded payment in full. When payment was not made, foreclosure was commenced and a notice of default was recorded.

The Romagnolis filed suit in state court to enjoin the foreclosure and for other relief. A motion for preliminary injunction was denied from which this appeal was taken. Foreclosure proceedings were enjoined pending the appeal. On appeal, the order denying preliminary injunction was reversed.

2. Ben, Hanlon, Dunn and Renner.

The facts of the *Ben, Hanlon, Dunn* and *Renner* cases are virtually identical to those of the *Romagnoli* case. In each case, appellees' precedessors-in-interest executed promissory notes and deeds of trust in favor of Cal Fed. All notes and deeds of trust contained substantially identical due-on-sale clauses. Upon the occurrence of the sales of the various real properties to the respective appellees, without the consent of Cal Fed, Cal Fed exercised its rights under the due-on-sale clauses and accelerated the balance due under each note.

In each instance, when appellees refused to pay the accelerated debt, Cal Fed initiated foreclosure proceedings by recording notices of default. Each of the appellees filed suit to enjoin the foreclosure proceedings. Appellees' motions for preliminary injunction were denied in each case. All appellees appealed from the orders denying injunctive relief. All appeals were consolidated and heard in the California Court of Appeal for the Fourth Appellate District, which court reversed the rulings of each of the trial courts. This appeal is taken from the opinion of the court of appeal in the consolidated cases.

The specific facts of the *Ben, Hanlon, Dunn* and *Renner* cases are set forth in the Appendix.

SUBSTANTIALITY OF QUESTIONS PRESENTED.

A. Summary.

These cases are appeals from state court decisions upholding a California state law, and thereby rejecting preemptive federal regulations, that severely restrict the enforceability of due-on-sale clauses by federal savings and loan associations. This state court action is in conflict with federal appellate decisions and violates the doctrine of preemption, dictated by the supremacy clause of the U.S. Constitution. Thus, this case presents a challenge to one of the fundamental precepts of our federal system.

This case also presents significant social and economic issues, since the state court decisions now under review affect the stability of the entire federal savings and loan association system. Also at stake is the value of billions of dollars of equity instruments sold through the secondary mortgage market, the proceeds of which are used by the savings and loan system to make new loans to prospective home buyers. Consequently, the outcome of this and related concurrent cases will have a significant, comprehensive effect upon all real estate secured financing in the United States.

B. Social and Economic Significance.

The creation of a nationwide system of federal savings and loan associations ("federal associations") was prompted by the widespread failure of financial institutions during the Depression. In 1933 Congress passed the Home Owners' Loan Act ("HOLA"), 12 U.S.C. §1461 *et seq.*, which created the Bank Board (12 C.F.R. §500 *et seq.*), to regulate the activities of the newly created federal associations.

In §5(a) of the HOLA Congress gave the Bank Board plenary power over the creation and operation of federal associations. That section provides:

> In order to provide local mutual thrift institutions in which people may invest their funds in order to provide the financing of homes, the [Bank] Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as 'Federal Savings and Loan Associations' . . . and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States. 12 U.S.C. §1464(a).

This system of federal associations was to be independent of state control, which had been at best randomly effective

and was deficient in many respects. *Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 604 F.2d 1256, 1257-58 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980). Specifically, state regulated thrift institutions had provided inadequate distribution and availability of home loans, and had followed lending practices that led in many instances to defaults by both borrowers and eventually the lenders themselves.

The system of federal associations has expanded greatly since its creation. For example, conventional single family mortgage originations by federal associations for the first six months of 1981 aggregated $23 billion. In 1980 Cal Fed held residential secured loans totalling $4,717,765,403. By year end in 1980 all federal associations in California originated $3,741,000,000 in residential loans during 1980, which was over one-third of the total loans made by all savings and loan associations in California in that year.

Pursuant to federal law (12 U.S.C. §1717(b)(2)), mortgages generated by federal associations are sold in secondary markets to raise new capital, which is then used to finance additional new mortgage loans. This secondary market functions under the aegis of two federal instrumentalities, the Federal Home Loan Mortgage Corporation ("FHLMC") and the Federal National Mortgage Association ("FNMA"). Both FHLMC and FNMA have promulgated uniform security agreements for use by lenders. The due-on-sale clause here in issue is a standard covenant in those uniform security agreements, and use of these agreements is a condition precedent to the purchase of a mortgage by FHLMC or FNMA. Of the $18.8 billion in conventional mortgages purchased after January 1, 1976 by FHLMC, all use the standard FHLMC/FNMA instruments. Similarly, substantially all the $18.4 billion in conventional mortgages owned by FNMA as of December 31, 1980 were originated on these standardized instruments.

A substantial portion of the mortgages purchased by the FHLMC originates in California, a chronically capital short

mortgage market during the last decade. Approximately 50% of all conventional mortgages purchased by FHLMC have been secured by real property located in California. During the last three calendar years (1978-80), FHLMC's purchases of California conventional mortgages supplied over 40% of the mortgage capital deficit of all California savings and loan associations.*

Because of the present structure of the national mortgage industry, the invalidation of due-on-sale clauses will have two distinct but related deleterious effects upon both the mortgage industry and homeowners. The revocation of the power to enforce due-on-sale clauses will result in an increase in the interest rate on available mortgage funds. Dept. of H.U.D. Report, *An Economic Analysis of Due-on-Sale Clauses* (April 1981) (hereinafter "H.U.D. Report"), at 22-23; R. Pratt & T. Campbell, Credit Research Center Monograph No. 14, *An Economic Analysis of The "Due on Sale" Clause in The California Mortgage Market* (Krannert Graduate School of Management, Purdue University, January 1979) (hereinafter "Monograph"; this document is in the Appendix), at 15-17, 22, 24-25. In addition, mortgages containing unenforceable due-on-sale clauses will become less appealing to the secondary mortgage market investor because of lengthened maturity (*e.g.*, the loan will not mature until the expiration of its 30 year term, instead of the time — normally five to seven years — of the borrower's sale of the property), consequent reduced yield on investment, and lender's increased risk of default because of inability to check credit on persons who assumed existing loans. Accordingly, if fewer investors buy such mortgages or pay lower prices for these mortgages, the pool of available

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*The California mortgage capital deficit, *i.e.*, the demand for mortgage funds less savings inflows, for all California savings and loan associations during 1978 through 1980 was $20.374 billion. During this same period FHLMC purchased $8.397 billion of California mortgages. Thus, FHLMC's purchase activity supplied 41.17% of the deficit.

new mortgage funds (*i.e.*, the proceeds of the sale of earlier mortgages in the secondary market) will be drastically reduced. This in turn will further depress the already staggering real estate market and construction industry. *See* H.U.D. Report, at 15-18; Advisory Opinion of the Federal Home Loan Bank Board (Resolution No. 75-647), known as the "Schott Opinion," which is reprinted in the Appendix.

C. The Application of Wellenkamp to Federal Associations Is Preempted by Federal Law.

Appellees rely upon California Civil Code §711, as construed in *Bank of America v. Wellenkamp*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), as the basis for their contention that due-on-sale clauses contained in lending security instruments issued by federal associations are not enforceable according to their express terms. The state law doctrine created by *Wellenkamp*, however, cannot be constitutionally applied to federal associations because to do so would create an inevitable conflict with a comprehensive scheme of federal law. U.S. Const. art. VI, cl. 2. Federal law authorizes the unfettered use of due-on-sale clauses by federal associations and, therefore, federal law must preempt and prevail over the conflicting *Wellenkamp* doctrine.

1. The Scope of Federal Regulation of Federal Associations Is Comprehensive.

The doctrine of federal preemption has its foundation in the supremacy clause of the U.S. Constitution:

> 2. This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme law of the land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding. U.S. Const. art. VI, cl. 2.

The supremacy clause has been interpreted broadly and uniformily by this Court to invalidate any state statute that relates to a subject matter area that is subject to federal legislation. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525-26, *reh. denied*, 431 U.S. 925 (1977). Thus, whenever a state statute is an obstacle to the full accomplishment and execution of the purposes and objectives of Congress in passing federal legislation in issue, the state statute falls. 430 U.S. at 526.

In *Bethlehem Steel Co. v. New York State Labor Rel. Bd.*, 330 U.S. 767, 774 (1947), this Court held that even when a federal enactment did not explicitly provide that all state law in the same realm was excluded, the nature of the federal enactment might require that conclusion. The cases are further uniform in holding that when it is the intention of Congress to legislate fully in a given field, all state statutes that conflict in any way with the federal requirements of uniformity are invalid by reason of the supremacy clause. Thus, even though Congress or the federal agency delegated with the responsibility to regulate pursuant to the federal enactment has not acted, if it is within the power of Congress or the agency to act in that area, all state statutes contrary to the congressional intent are preempted. *E.g.*, *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973); *Napier v. Atlantic Coastline R.R.*, 272 U.S. 605 (1926).

The foregoing authorities show that preemption occurs in four basic modes. There can be preemption: (1) when federal law expressly precludes state action, (2) when state law is in direct conflict with federal law, (3) when Congress by its enactments has wholly occupied a given field, and (4) when state law stands as an obstacle or threatens potential interference with the purpose and objective of the federal legislation.

Whether or not California Civil Code §711 is preempted requires an examination of federal legislation pertinent to the system of federal associations. As previously noted, §5(a) of the HOLA gave the Bank Board plenary power over the operation of federal associations. 12 U.S.C. §1464(a). Pursuant to this statutory authorization the Bank Board has adopted numerous regulations controlling federal associations. With virtual unanimity previous courts have held that these regulations are valid and preemptive of conflicting state law.

The HOLA directed the Bank Board to regulate the national system of federal associations by adopting the "best practices" of existing state regulatory agencies. HOLA, §5(a). This federal system has long been recognized as being subject solely to federal regulation. *See First Fed. Sav. & Loan Ass'n of Boston v. State Tax Commission*, 437 U.S. 255, 258 n.3 (1978) ("the federal statute protects federal associations from being forced into the state regulatory mold"); *accord*, Opinion of California Attorney General No. 64-222 (Aug. 24, 1964) ("federal regulation of federal associations leaves no room for the application of state law"), 44 Ops. Cal. Atty. Gen. 50, 51 (1965).

Numerous federal courts have concluded that the HOLA and the Bank Board's implementing regulations comprise an exclusive body of law governing federal associations.*

**Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 604 F.2d 1256, 1257-58, 1260 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980); *First Fed. Sav. & Loan Ass'n of Boston v. Greenwald*, 591 F.2d 417, 425 (1st Cir. 1979); *Kupiec v. Republic Fed. Sav. & Loan Ass'n*, 512 F.2d 147 (7th Cir. 1975); *Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n*, 499 F.2d 1145 (9th Cir. 1974); *Central Sav. & Loan Ass'n of Charitown v. Federal Home Loan Bank Board*, 422 F.2d 504 (8th Cir. 1970); *Murphy v. Colonial Fed. Sav. & Loan Ass'n*, 388 F.2d 609 (2d Cir. 1967); *Dantus v. First Fed. Sav. & Loan Ass'n of Denver*, 502 F. Supp. 658 (D. Colo. 1980); *Williams v. First Fed. Sav. & Loan Ass'n of Arlington*, 500 F. Supp. 307 (E.D. Va. 1980), *aff'd*, 651 F.2d 910 (4th Cir. 1981); *Bailey v. First Fed. Sav. & Loan Ass'n of Ottowa*, 467 F. Supp. 1139 (C.D. Ill. 1979); *Glendale Fed. Sav. & Loan Ass'n v. Fox*,

The rationale in some of these cases was that Congress intended the HOLA (and the regulations adopted thereunder) to preempt state law. In other cases the courts held that the state law in issue was preempted because it conflicted with the HOLA or Bank Board regulations.

The conflict between these decisions and the opinion of the California Court of Appeal in the instant case is typified by the opinion of the ninth circuit in *Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 604 F.2d 1256 (9th Cir. 1979). In that case the State of California attempted to impose upon federal associations a state law that prohibited lenders from discriminating against prospective loans secured by property in "redlined" areas. The district court and the ninth circuit ruled against the State of California on the ground that this state law impinged upon an area exclusively within the scope of federal regulations and, therefore, was preempted by federal law. This decision was affirmed by this Court. *Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 445 U.S. 921 (1980) (memorandum).

The ninth circuit traced the history of the HOLA and other legislation and concluded that federal legislation provided the Bank Board with authority to promulgate rules and regulations prohibiting discrimination. The court concluded that:

> In our judgment the regulatory control of the Bank Board over federal savings and loan associations is so pervasive as to leave no room for state regulatory con-

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459 F. Supp. 903 (C.D. Cal. 1978), *rev'd on other grounds*, ____ F.2d ____ (9th Cir., Sept. 25, 1981; No. 79-3573); *Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n*, 405 F. Supp. 819 (N.D. Ill. 1975); *City Fed. Sav. & Loan Ass'n v. Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975); *Lyons Sav. & Loan Ass'n v. Fed. Home Loan Bank Board*, 377 F. Supp. 11 (N.D. Ill. 1974); *Elwert v. Pacific First Fed. Sav. & Loan Ass'n*, 138 F. Supp. 395 (D. Or. 1956); *People v. First Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311 (S.D. Cal. 1951); *Kaski v. First Fed. Sav. & Loan Ass'n of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (Wis. 1976); *Washington Fed. Sav. & Loan Ass'n v. Balaban*, 281 So. 2d 15 (Fla. 1973); *Springfield Inst. v. Worcester Fed. Sav. & Loan Ass'n*, 329 Mass. 184, 107 N.E. 2d 315, *cert. denied*, 344 U.S. 884 (1952).

trol. As this court noted in *Meyers v. Beverly Hills Federal Savings & Loan Ass'n.*, 499 F.2d 1145, 1147 (9th Cir. 1974):

> 'Pursuant to its valid statutory authority, the Federal Home Loan Bank Board has promulgated comprehensive regulations covering all aspects of every federal savings and loan association "from its cradle to its corporate grave." *People of State of California v. Coast Federal Savings and Loan Ass'n.*, S.D. Cal. 1951, 98 F.Supp. 311, 316.'
>
> The broad regulatory authority over the federal associations conferred upon the Bank Board by HOLA does wholly preempt the field of regulatory control over these associations. If state-conferred rights are to be enforced against the federal associations by any regulatory body (a question we do not reach), enforcement must be by the Bank Board. 604 F.2d at 1260.

The foregoing requires a holding of federal preemption of California law purporting to regulate the right and power of federal associations to freely enforce due-on-sale clauses in deeds of trust. This holding is also further supported by the specific due-on-sale regulations and statements of policy adopted by the Bank Board in 1976 and 1981.

A more recent conflict was created by the fourth circuit's decision in *Williams v. First Fed. Sav. & Loan Ass'n of Arlington*, 651 F.2d 910 (4th Cir. 1981), where the court of appeals reached a holding directly contrary to the California Supreme Court's *Wellenkamp* decision and, in so doing, described *Wellenkamp* as a "combination of non-sequitur and unsupported assumptions." 651 F.2d at 923 n.29. The court of appeals held that the due-on-sale clause did not constitute an unreasonable restraint on alienation and was not invalid. By virtue of this case there is now a fundamental disparity in the efficacy of due-on-sale clauses between the fourth and ninth circuits. In the fourth circuit

all lenders may enforce due-on-sale clauses; in the ninth circuit, at least in California, lenders may not enforce such clauses.

2. The Bank Board's Due-On-Sale Regulations and Resolutions Compel a Finding of Preemption.

The conflict created by the California court in the instant case is direct, significant, and intentional. It cannot be distinguished as a minor inconsistency; consequently, a hearing by this Court is required in order to clarify the existing law in this area.

On July 30, 1975 the Bank Board adopted as its formal Resolution No. 75-647, the Schott Opinion, which the Bank Board was requested to provide to the U.S. District Court for the Central District of California in *Schott v. Mission Fed. Sav. & Loan Ass'n*, Case No. Civ. 75-366 WMB. The Bank Board was asked to state its position on automatic acceleration under due-on-sale clauses by federal associations, the precise issue in question in this case. That opinion concluded that the Bank Board, even without the express regulation, has viewed favorably the use of due-on-sale clauses by federal savings and loan associations. The Schott Opinion, in Part Two, commencing on page 19, sets forth the reasons why national uniformity *requires* that federal associations have the flexibility afforded by due-on-sale clauses, regardless of what state law may otherwise provide.

Subsequently, on August 28, 1976, the Bank Board adopted its Resolution No. 76-296, specifically providing that a federal association may accelerate automatically under a due-on-sale clause, entirely independent of any state law to the contrary and subject only to federally-imposed limitations as to single family dwellings. In a Statement of Policy explaining the regulations the Bank Board concluded:

> *Finally, it was and is the Board's intent to have late charges and due-on-sale practices of federal associations governed exclusively by federal law.* Therefore,

charging of late charges and exercise of due-on-sale clauses by federal associations shall be governed and controlled solely by Section 545.6-11 and the Board's new Statement of Policy. *Federal associations shall not be bound or subject to any conflicting state law which imposes different late charges or due-on-sale requirements*, nor shall federal associations attempt to impose higher late charges than permitted in Section 545.6-11(e) or avoid the limitations on the exercise of due-on-sale clauses delineated in Section 545.6-11(g)* on the ground that such prior charge or avoidance of limitations is permissible under state law.

The regulation provides expressly that:

> [The federal association] may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent.
>
> . . . .
>
> [The] exercise by an association of such an acceleration option (hereinafter called a due-on-sale clause) shall be governed exclusively by the terms of the contract by the association and the borrowers, and all rights and remedies of the association and borrower thereto shall be fixed and governed by said contract. (Emphasis added.)

This regulation and the Statement of Policy are an express statement that only the contract and the terms of the contract shall affect when and in what manner the due-on-sale clause may be exercised.

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*The regulation was originally 12 C.F.R. §545.6-11(f-g) but was renumbered as §545.8-3(f), effective August 2, 1979. Minor amendment was made in the language of the section. The changes are not material and do not affect this appeal.

On July 23, 1981 the Bank Board adopted a new Statement of Policy, which expressly established the preemptive nature of the Bank Board's authorization and regulation of the use of due-on-sale clauses by federal associations.* 46 Fed. Reg. 39123-24 (July 31, 1981).

The new Statement of Policy provides:

> Imposition of late charges and due-on-sale clauses.
>
> . . . .
>
> (f) Due-on-sale policy and Federal preemption.
>
> (1) Federal associations are obliged to take reasonable precautions to protect themselves against the economic risks associated with mortgage lending, including the risk that the cost of lendable funds will exceed the yield from existing mortgage loans, and that sharply rising interest rates will reduce substantially the value of existing mortgage assets. In this connection, the Board has determined that the due-on-sale clause normally is a valuable and often an indispensable source of protection for the financial soundness of Federal associations and for their continued ability to fund new home loan commitments. Consequently, the Board for many years has authorized due-on-sale clauses for use by Federal associations. However, because the Board desires to afford associations the flexibility to accommodate special situations and circumstances, §545.8-3(f) of this subchapter by its terms merely authorizes rather than compels the conclusion and exercise of due-on-sale clauses in mortgage loans.
>
> (2) Paragraph (f) of §545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses, subject only to the express lim-

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*Subsequently the Comptroller of the Currency requested comments on a similar proposed regulation affecting the use of due-on-sale clauses by national banking associations. 46 Fed. Reg. 46964 (Sept. 23, 1981).

> itations contained in §545.8-3(g). Due-on-sale practices of federal associations shall be governed exclusively by the Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers). 12 C.F.R. §556.9(f) (emphasis added).

Thus, the Bank Board, the agency empowered by Congress under the HOLA to regulate federal associations, has emphatically and unequivocally declared that federal associations are entitled to accelerate automatically under the due-on-sale clauses in their notes and deeds of trust, notwithstanding any and all state statutes to the contrary, including state law prohibitions against restraints against alienation, such as California Civil Code §711.

In summary, the law of California is totally preempted as to when and in what manner due-on-sale clauses may be enforced by Cal Fed. Accordingly, the decisions of the California Court of Appeal that failed to find preemption and that purport to apply *Wellenkamp* to federal associations raise a substantial federal question as to the supremacy of federal law over conflicting state law. These decisions affect the validity of billions of dollars worth of real estate loans and the ability of the federal government to regulate interstate commerce.

D. The Wellenkamp Rule Was Given an Unconstitutional Retrospective Application in This Case.

The lending instruments in these cases were executed from two to five years before the California Supreme Court's decision in *Wellenkamp*, and were fully enforceable at the time of execution. *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505 (1964). To apply *Wellenkamp* to

these cases impairs the obligation created by the Cal Fed lending instruments and constitutes an unconstitutional divestiture of vested contract rights.*

The U.S. Constitution provides that no state shall make any ex post facto law or any law impairing the obligation of contracts. U.S. Const. art. I, §10. The California Constitution contains an analogous provision. Cal. Const. art. 1, §9. By applying *Wellenkamp* retroactively, the California Court of Appeal impaired Cal Fed's interest in its contract, *i.e.*, the lending instruments, thus unconstitutionally depriving Cal Fed of its property. *See Bechtel v. Nelson*, 10 Cal. App. 2d 66, 51 P.2d 99 (1935); *Bennett v. Superior Court*, 5 Cal. App. 2d 13, 42 P.2d 80 (1935).

Moreover, in announcing *Wellenkamp*'s retroactive application, the California Supreme Court violated its own principles governing the retrospective operation of a court decision overruling an earlier decision. The rule is that an overruling decision will not be given retroactive effect if it would invalidate prior contracts or vested rights. *Los Angeles County v. Faus*, 48 Cal. 2d 672, 680-81, 312 P.2d 680, 685-86 (1957). The Cal Fed lending instruments created vested, contractual rights that were valid when created. *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505 (1964). Consequently, *Wellenkamp* should not have been applied to divest these rights.

CONCLUSION.

The issues presented by these related cases have an enormous effect, measured in billions of dollars, upon the nation's primary means of financing home ownership. Consequently, these cases also have a direct and equally

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*As has been noted in economic analyses of the use of due-on-sale clauses, the retroactive application of *Wellenkamp* has the practical effect of taking property from lenders and giving it to existing borrowers, with *no* benefit flowing to subsequent assignees of the now-assumable loans. Monograph, at 24-25; H.U.D. Report, at 5-6.

profound social significance. Furthermore, the legal issue of federal preemption affects the continued vitality of our entire federal system of government. These issues in this case are of paramount significance and deserve a hearing in this Court and a reversal of the decisions of the California Court of Appeal.

Dated: November 23, 1981.

Respectfully submitted,

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